VSA Stocks Presentation

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What is Volume Spread Analysis?

- If I look under the bonnet of my car I know the names of several of the component parts but understand little about how they work or interact with each other.
- In this presentation I will look beyond the indicator names and VSA principles to explain what is happening between buyers and sellers at important price levels.
- By then combining this understanding with support and resistance levels VSA becomes a very powerful tool to help us understand the financial markets.
- Today I will be focusing on stocks but the teaching can be applied to any other financial market.

A Guide to Understanding The Basics of Volume Spread Analysis

- Many of you will have read my first book ‘My Journey of Discovery to Wyckoff Volume Spread Analysis’. Several years ago I mentioned to Tom that I had pages of notes accumulated over the years and he suggested I produce a book. From memory I just laughed and said what do I know about writing a book? But, as usual, Tom was right and with his encouragement I finished that book and have now written a second book which aims to simplify VSA for those who are starting out. In this book the focus was on explaining what happens ‘under the car bonnet’ without using lots of terms that a newcomer did not understand.

Why Use VSA?

- There are essentially three ways to invest or trade in stocks:
- 1. Fundamentals (not of great use if you are trading in and out of stocks every few minutes).
- 2. Technical Analysis – using mathematical indicators. These are unreliable at tops and bottoms due to their lagging nature.
- 3. VSA – following the activity of the large investors (who are ‘in the know’) by looking at price range or spread of each bar, the volume and the closing price. This is my preferred choice.
- When investing in stocks long term I do use fundamentals to exclude certain stocks from my VSA analysis. For example, I may choose not to look at stocks with poor cash flow or excessive debt. Others may decide that they simply want to use VSA and nothing else. The choice is yours.

The Laws

- 1. Law of Supply and Demand – this lies at the heart of VSA. Supply is the sellers and Demand is the buyers. The interaction between the two represents skirmishes in the battlefield on each bar. Sometimes there is a major battle (when volume or activity is huge) which gives us valuable information as to the future path of price. This allows us to follow in the footsteps of the large investors.
- Most of the activity (volume) is the result of investing and trading by the large investors.

The Laws

- 2. Law of Effort versus Result – effort is the activity taking place on a particular bar. The result of that activity is the price movement. If the effort is all buying price should move up with ease. If there are both buyers and sellers present the price range will indicate to us who was in control ON THAT BAR. To see who has overall control you need to study important bars in the background.
- 3. Law of Cause and Effect – there has to be a cause to justify an effect. A market rise or fall will be due to a cause in the background of the chart.

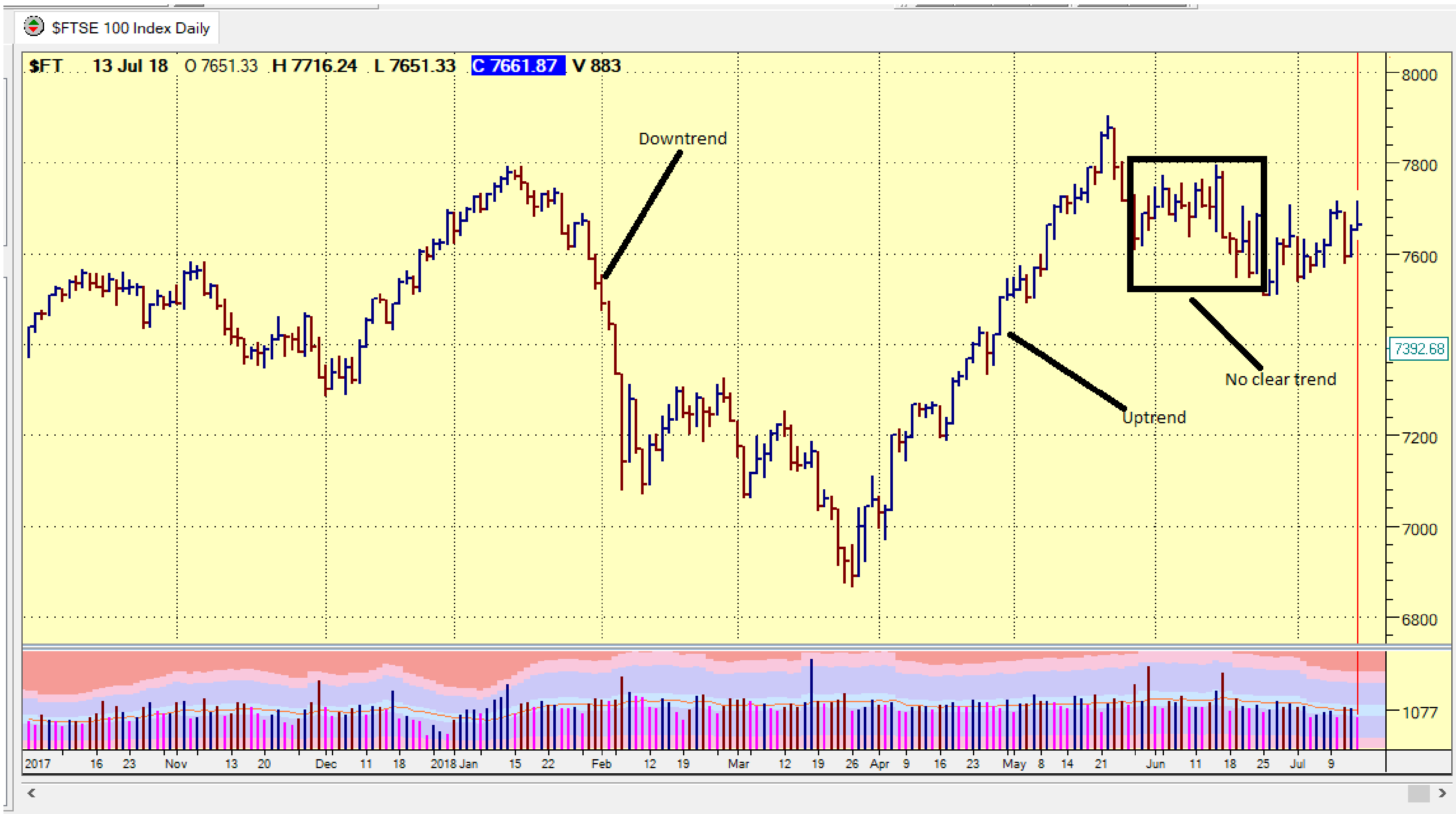
The Laws

- 3. Fear and Greed – the human brain is not wired to cope well with the activities of financial markets. If a company announces good results but its’ share price is marked up and then falls sharply we find this confusing. Equally when another company announces poor results the share price falls but later rebounds sharply higher. Often prices fall on apparent good news and rise on bad news. This is because markets ANTICIPATE. The large investors do not take notice of the media and will have studied the companies in which they invest very carefully. They buy when prices are low and the media are saying sell. And they sell when prices are high and the media are saying buy. Human beings love acting as a group and have herd instincts. They are uncomfortable acting against the majority. Fund managers may sense the market is topping out but fear selling in case the market goes up for a few more months and they lose their jobs prior to the price decline.

Support and Resistance

- Support and resistance are very important and dovetail with VSA. I would never use one without the other.
- In chart 2 on the next slide it is important to understand the three phases of the market. A clear uptrend and downtrend have been labelled. But at times there is no clear trend when prices simply move sideways.
- For an uptrend or downtrend to take place there has to be a cause. This will be either major buying by large investors prior to the up move or major selling by large investors prior to the down move.

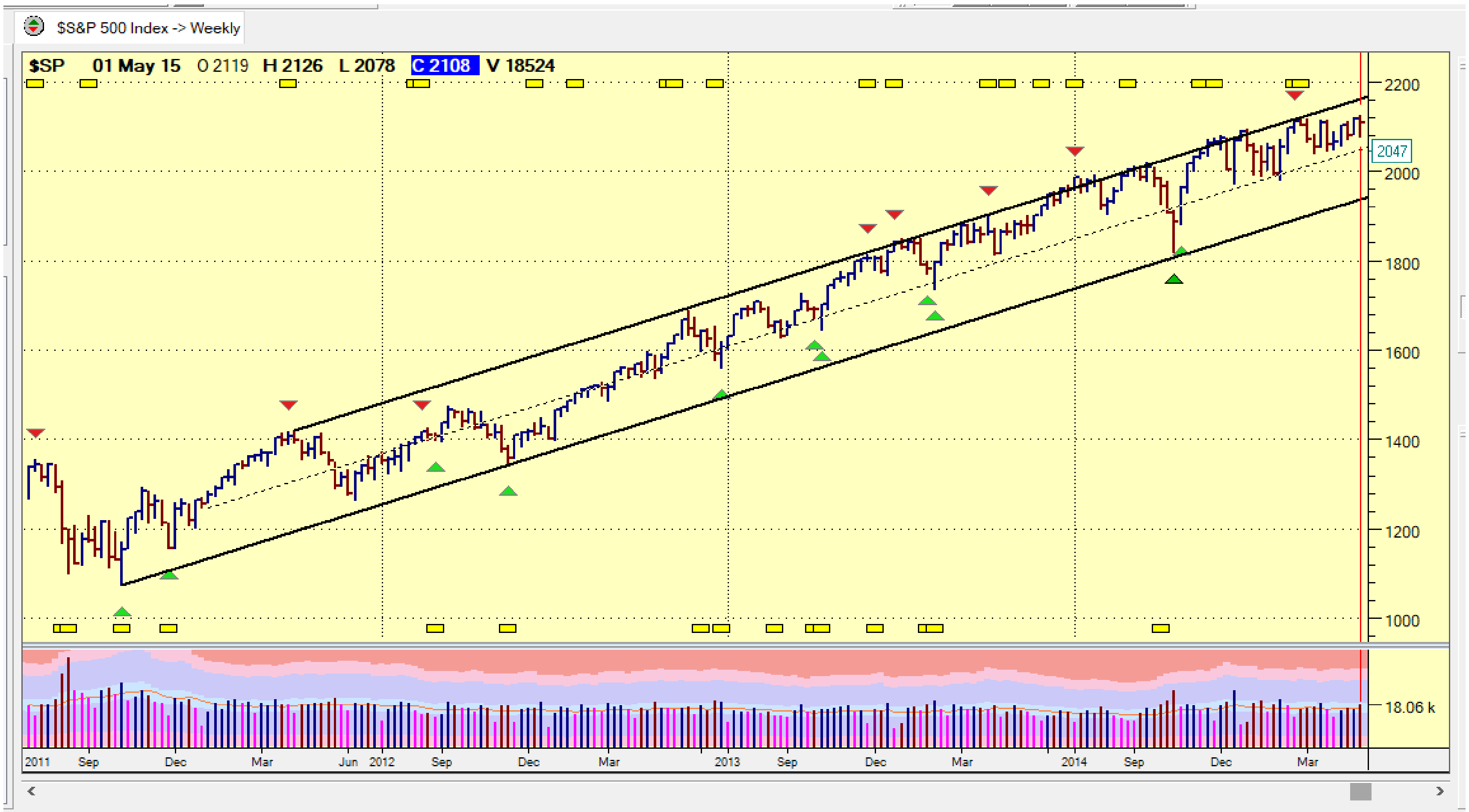
Support and Resistance



Support and Resistance

- When I first met Tom Williams he always said you must draw a trend channel as without it there is a part of the chart missing.
- On the next slide is the S&P 500 weekly cash index shown up to May 2015. It is a perfect example of how important the trend channel can be. It is simply two parallel lines drawn from either the first two lows and intervening high (for an up trend) or first two highs and intervening low (for a down trend).

Support and Resistance – Trend Channels



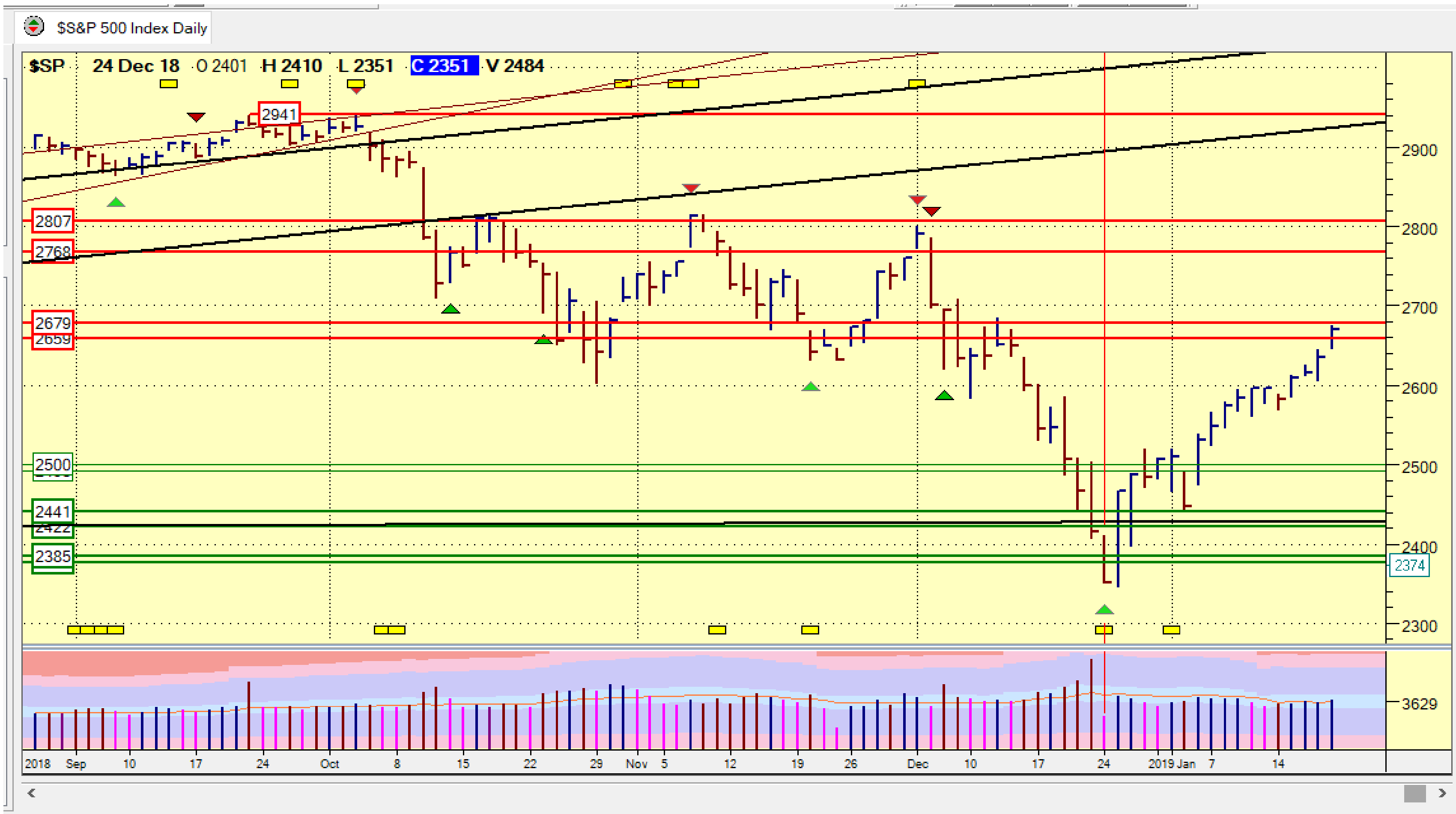
Support and Resistance

- Very high volume bars in the background of the chart are important to our analysis. The high volume indicates that large investors were active here so by drawing horizontal lines into the future from these bars it is possible to see where future support and resistance will appear.
- Volume Profile is a useful tool which does a lot of the work for you and this is now available in a number of platforms.

Support and Resistance

- On the following slide is a daily chart of the S&P 500 index. Here I have drawn horizontal lines of support and resistance from previous very high volumes bars.
- As price starts to decline note how the area between 2659 and 2679 acts as support on several occasions and 2768 to 2807 acts as resistance. By combining these areas with VSA analysis on the approaches to these price zones it is possible to anticipate what price is likely to do.
- As price fell towards the lows in December 2018 note the very high volume bar followed by a low volume bar showing selling had been exhausted. This price action will be covered in more detail later.

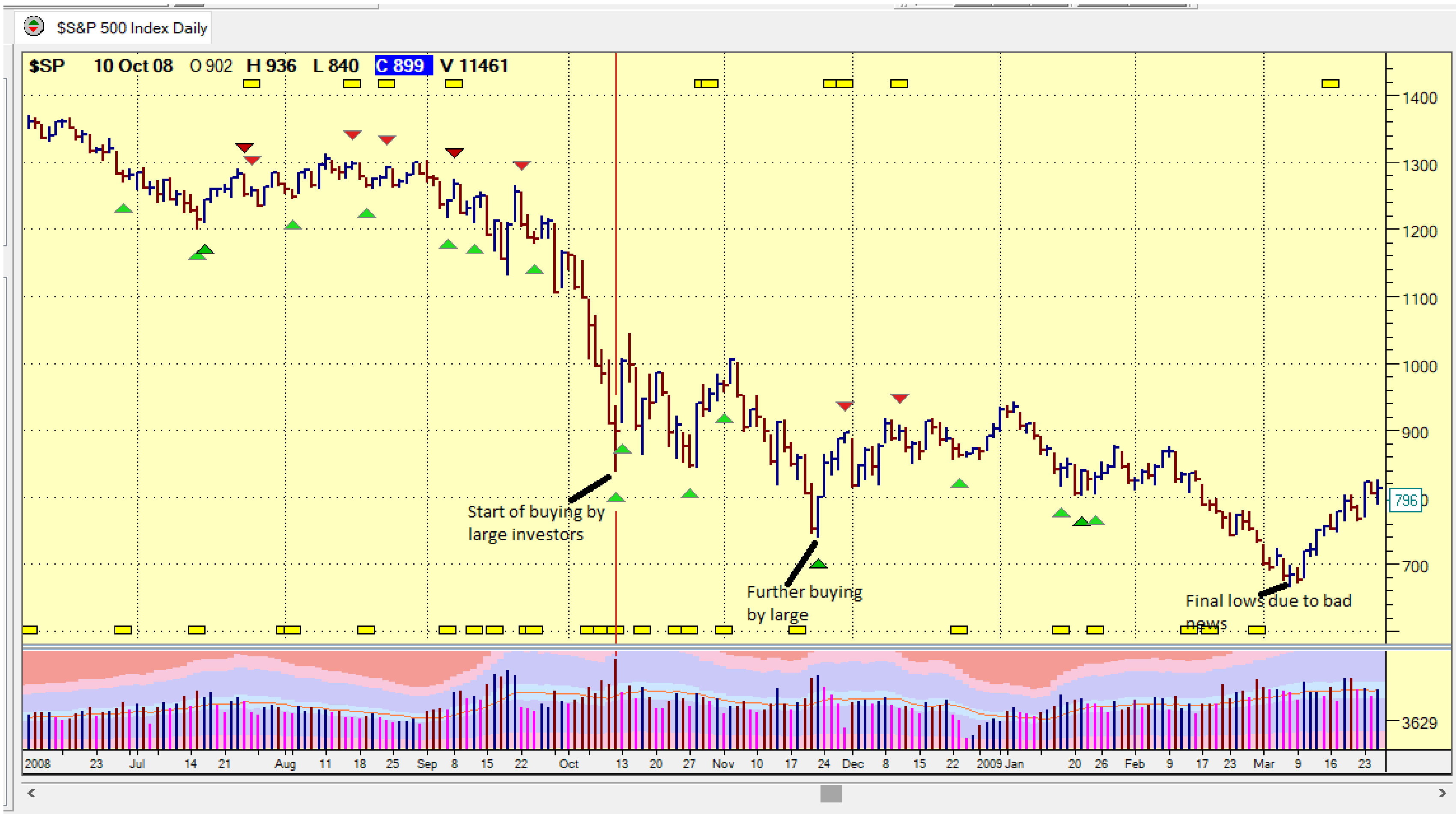
Support and Resistance-Horizontal Lines



The Term ‘Accumulation’

- Let’s set the scene. The stock index has been falling for some time, the media is bearish and saying sell, sell, sell. You feel very negative about stocks because of the economic climate and negative news.
- But when you look at the chart, price is falling on massive volume but closing off the low of the bar. This can only be because the large investors are starting to move in and buy. However, there are still lots of sellers present meaning this is not yet the time to buy.
- Look at the next slide to see how buying in the S&P 500 index actually started in October 2008.
- The start of buying came in October 2008 but with lots of panic selling. In late November there was further buying but volume was lower indicating less panic sellers. Finally in early March 2009 bad news allowed prices to be marked down even lower but volume was less than in December 2008 again indicating that panic selling had reduced even further. So each time a new price low was made there were fewer panic sellers around which sent a clear message to the large investors that the index was now set for a recovery.

Accumulation



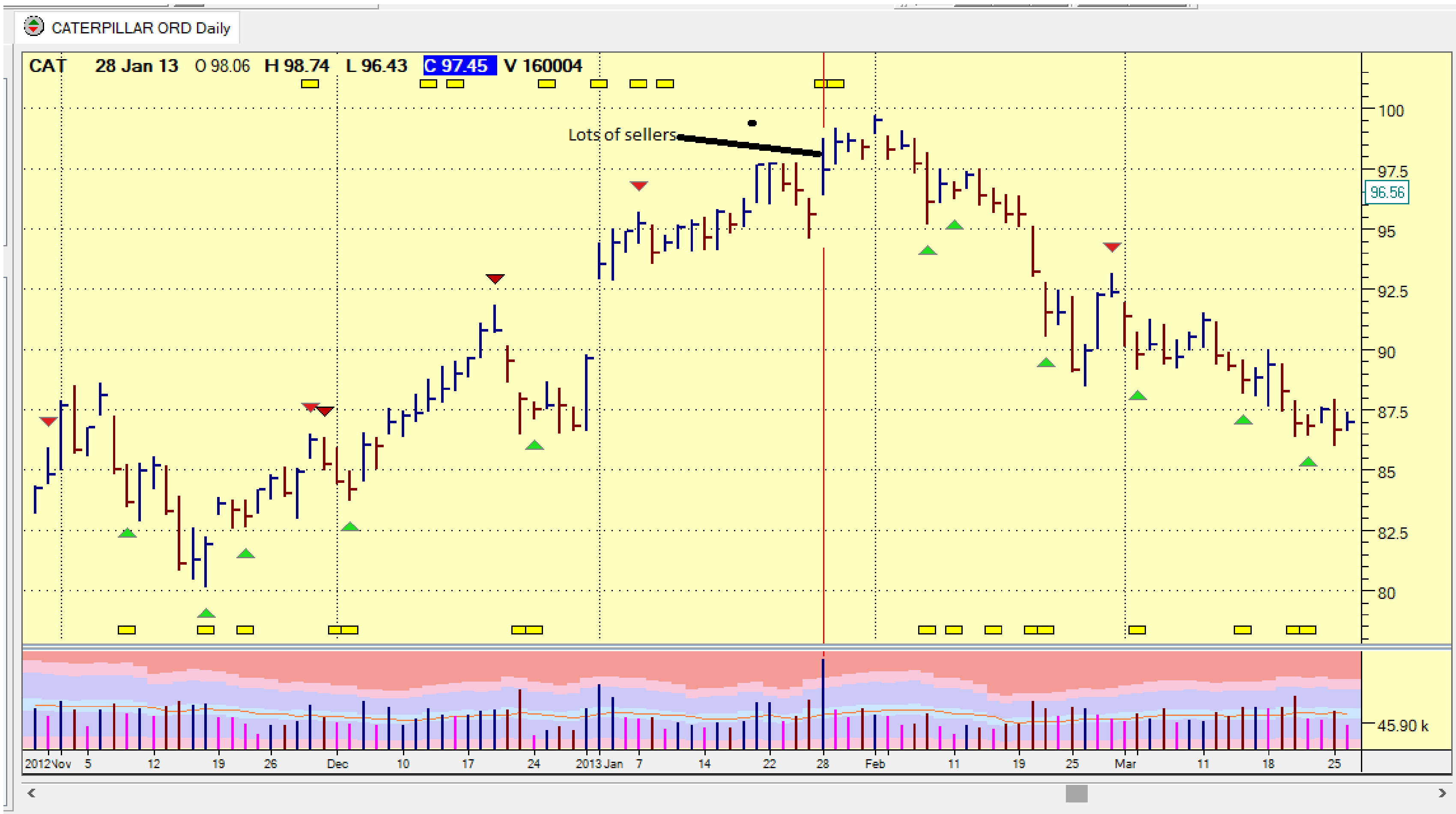
Accumulation

- So the term ‘accumulation’ is simply a transfer of shares from the public (who are uninformed) to the large investors (who are informed) and this occurs as price approaches the lows. The large investors have to buy in this way so as not to push up price against them.
- To summarise, accumulation follows a downtrend in price. It is accompanied by bad news in the media, activity will be huge as the public panic and sell their remaining stocks to the large investors who gratefully buy in anticipation of higher prices.
- Once this accumulation is complete the market is then primed to rally once the large investors have checked to make sure that there are no further panic sellers around. This is done by ‘testing’ which is described later in ‘setups’.

The Term ‘Distribution’

- Again let’s set the scene. The stock has been rising for some time, the media is bullish and saying buy, buy, buy. You feel very positive about stocks because of the economic climate and positive news.
- But when you look at the chart, price is rising on massive volume but closing off the high of the bar. This can only be because the large investors are starting to sell. However, there are still lots of buyers present meaning this is not yet the time to sell.
- Look at the next slide to see how selling in the US stock Caterpillar actually started on 2nd January 2013.
- The start of selling came on 2nd January 2013 but with lots of public buying. By 28th there was further selling by the large investors. Finally at the start of February price began to be marked down and the downward movement was underway.
- Once the buying by the public has been exhausted there is nothing left to hold price up.

Distribution



Other Points

- Liquidity – be aware that some stocks have poor liquidity which can affect the price spread between bid and offer. Keeping to stocks that you know is a good way of avoiding this issue. Certain smaller stocks can be a real problem to trade or invest in size.
- Also price spreads are wider at certain times of the day.
- The large investors tend to specialise so will operate in a certain number of stocks with which they are familiar.
- Have a written investment trading plan. Be patient waiting for the right opportunity. Be disciplined to follow your approach in your plan.
- A portfolio should have some diversification across different sectors. Don’t have all your eggs in one basket.
- Use the trend of the parent index as your guide. Buy stocks as an investor when the parent index is showing strength. Do not try and fight against the parent index.
- Money management is crucial.
- Look carefully at the psychological aspect of investing/trading.

Distribution

- So the term ‘distribution’ is simply a transfer of shares from the large investors (who are informed) to the public (who are uninformed) and this occurs as price approaches the highs. The large investors have to sell in this way so as not to alarm other investors before their sales have been completed.
- To summarise, distribution follows an uptrend in price. It is accompanied by good news in the media, activity will be huge as the public buy (for fear of missing out) from the large investors who gratefully sell in anticipation of lower prices.
- Once this distribution is complete the market is then primed to fall once the large investors have checked to make sure that there is no further public buying around. This is done by ‘no demand’ which is described later in ‘setups’.

BUY SET UP 1

- This first buy set up follows after accumulation has taken place in the stock.
- Make sure that the parent index has either undergone accumulation or is showing strength.
- The stock itself should have undergone accumulation.
- Wait for price to rise above the top of the accumulation area. Look for the first huge volume bar where accumulation began. Draw a horizontal line from the top of that bar (see chart, line at 17.10)

BUY SET UP 1

- Now look for price to move and close above the horizontal line that has been drawn at 17.10.
- Wait for a test. A test is a mark down in price (once above the top of the horizontal line) which then rebounds up off the low of the bar and activity is low. This indicates there is little selling as price is marked down. Make sure the close of the test bar is above the horizontal line. Once price closes above the top of the test bar a long position can be considered. Make sure the subsequent bar is a strong bar (volume average to high but not huge, and closing near the high of the bar).
- A stop loss should be placed below the low of the last huge volume bar as it will take effort to push below it.
- Make sure that the ratio of risk/reward is at least 2:1 in your favour and aim to move the stop loss to break even as soon as possible.

BUY SET UP 1

APPLE ORD Daily
AAPL 06 Aug 08 O 22.85 H 23.91 L 22.57 C 23.46 V 1.98 M
17.10
12.14
16.71
First bar of buying by large investors
Test
26
24
22
20
18
16
14
12
10
414.97 k
2008
Oct
Nov
Jan
Feb
Apr
May

BUY SET UP 1

APPLE ORD Daily
AAPL 02 Oct 09 O 25.92 H 26.56 L 25.91 C 26.41 V 1.38 M
28.26
26.51
24.24
21.39
19.92
18.70
17.10
16.71
12.14
Test
28
26
24
22
20
18
16
14
12
10
414.97 k
2008
Jan
Feb
Apr
May
Jul
Aug
Oct

BUY SET UP 2

- This next set up is simpler to follow.
- Firstly look for a stock that is in an up trend with strength in the background.
- Ensure that there are no huge volume bars in the background of the stock chart at higher prices as these will represent significant resistance.
- Make sure that the parent index is also in an uptrend.
- Look for a test on the stock chart. This is a mark down in price on reduced volume (lower than the two previous bars and not high or greater volume). The bar should close off it's low.
- Once price closes above the top of the test bar a long position can be considered. Make sure the subsequent bar is a strong bar (volume average to high but not huge, and closing near the high of the bar).
- A stop loss should be placed below the low of the last huge volume bar as it will take effort to push below it.
- Make sure that the ratio of risk/reward is at least 2:1 in your favour and aim to move the stop loss to break even as soon as possible.

BUY SET UP 2

AMERICAN EXPRESS Daily
AXP 03 Nov 16 O 65.53 H 65.76 L 65.04 C 65.33 V 37964
Stop below low of this bar
Test
58.89
63.53
74
72
70
68
66
64
62
60
58
44.54 k
34.92
2016
11
18
25
Aug
8
15
22
29
Sep
6
12
19
26
Oct
10
17
24
Nov
7
14

BUY SET UP 2

- In the example on the previous slide using American Express price had already risen above the accumulation zone and the test highlighted on 3rd November 2016 gave a potential long entry.
- Once price gapped up on the next bar and opened at 66.85 a long position could have been taken with a stop loss at 64.5 (just below the low of the huge volume bar of 20th October)
- The risk would be 2.35 so a reward of 4.70 was needed to justify the trade. That meant price had to rally to a minimum of 71.55.

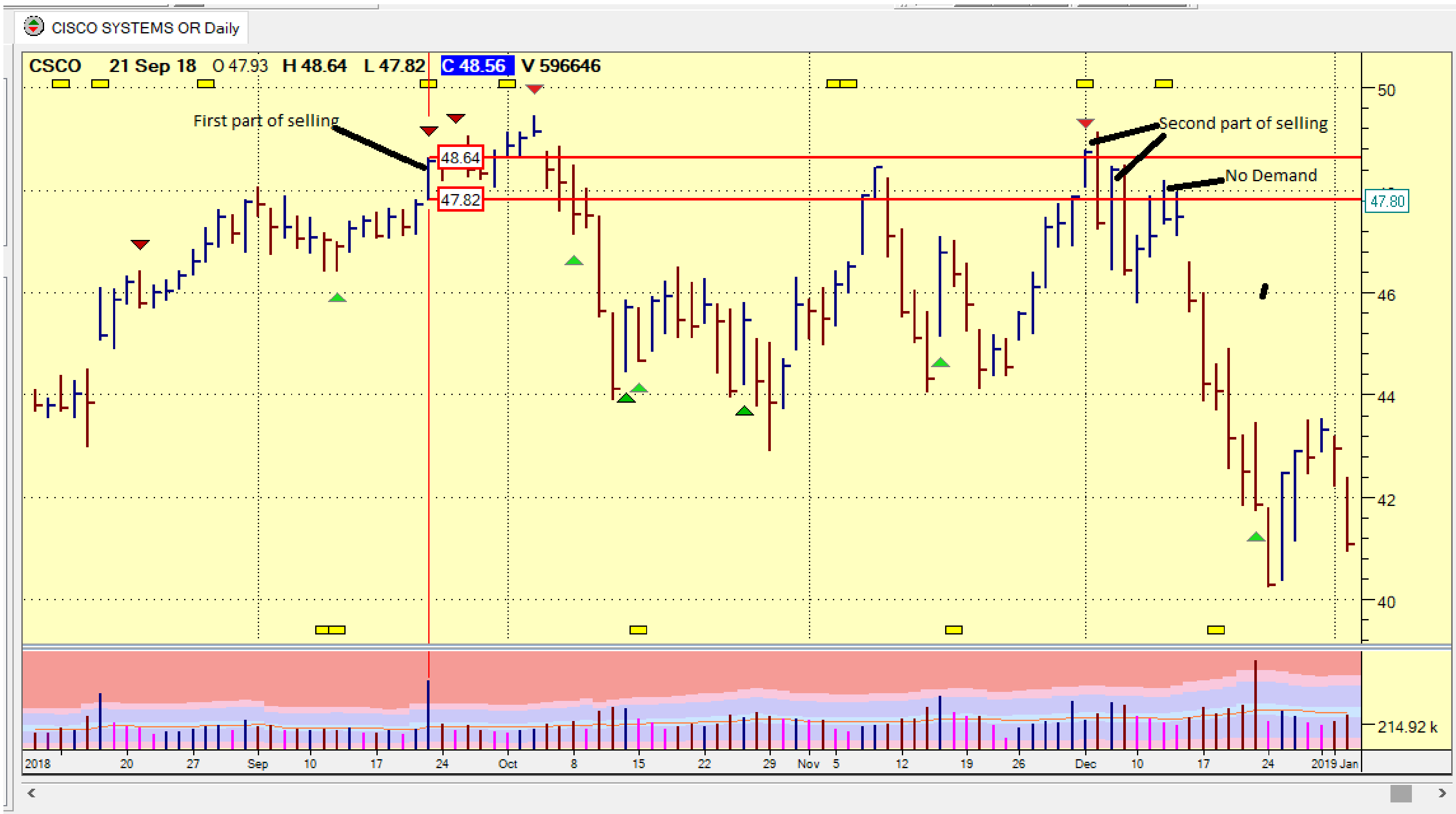
SELL SET UP 1

- This first sell set up follows after distribution has taken place in the stock.
- Make sure that the parent index has either undergone distribution or is showing weakness.
- The stock itself should have undergone distribution.
- Wait for price to fall below the bottom of the distribution area. Look for the first huge volume bar where distribution began. Draw a horizontal line from the low of that bar (at 47.82).
- I personally find accumulation easier to read on charts as distribution can appear complex. In the example shown price broke down from the distribution area and following some minor buying pushed back up for further distribution prior to the main decline. Recent action suggests possible re-accumulation in late December 2018.

SELL SET UP 1

- Now look for price to move and close below the horizontal line that has been drawn at 47.82.
- Wait for a no demand. A no demand is a mark up in price (once below the bottom of the horizontal line) which then falls off the high of the bar and activity is low. This indicates there is little buying as price is marked up. Make sure the close of the no demand bar is below the horizontal line. Once price closes below the bottom of the no demand bar a short position can be considered. Make sure the subsequent bar is a weak bar (volume average to high but not huge, and closing near the low of the bar).
- A stop loss should be placed above the high of the last huge volume bar as it will take effort to push above it.
- Make sure that the ratio of risk/reward is at least 2:1 in your favour and aim to move the stop loss to break even as soon as possible.

SELL SET UP 1


CISCO SYSTEMS OR Daily
CSCO 21 Sep 18 O 47.93 H 48.64 L 47.82 C 48.56 V 596646
First part of selling
48.64
47.82
Second part of selling
No Demand
47.80
50
46
44
42
40
214.92 k
2018
20
27
Sep
10
17
24
Oct
8
15
22
29
Nov
5
12
19
26
Dec
10
17
24
2019 Jan

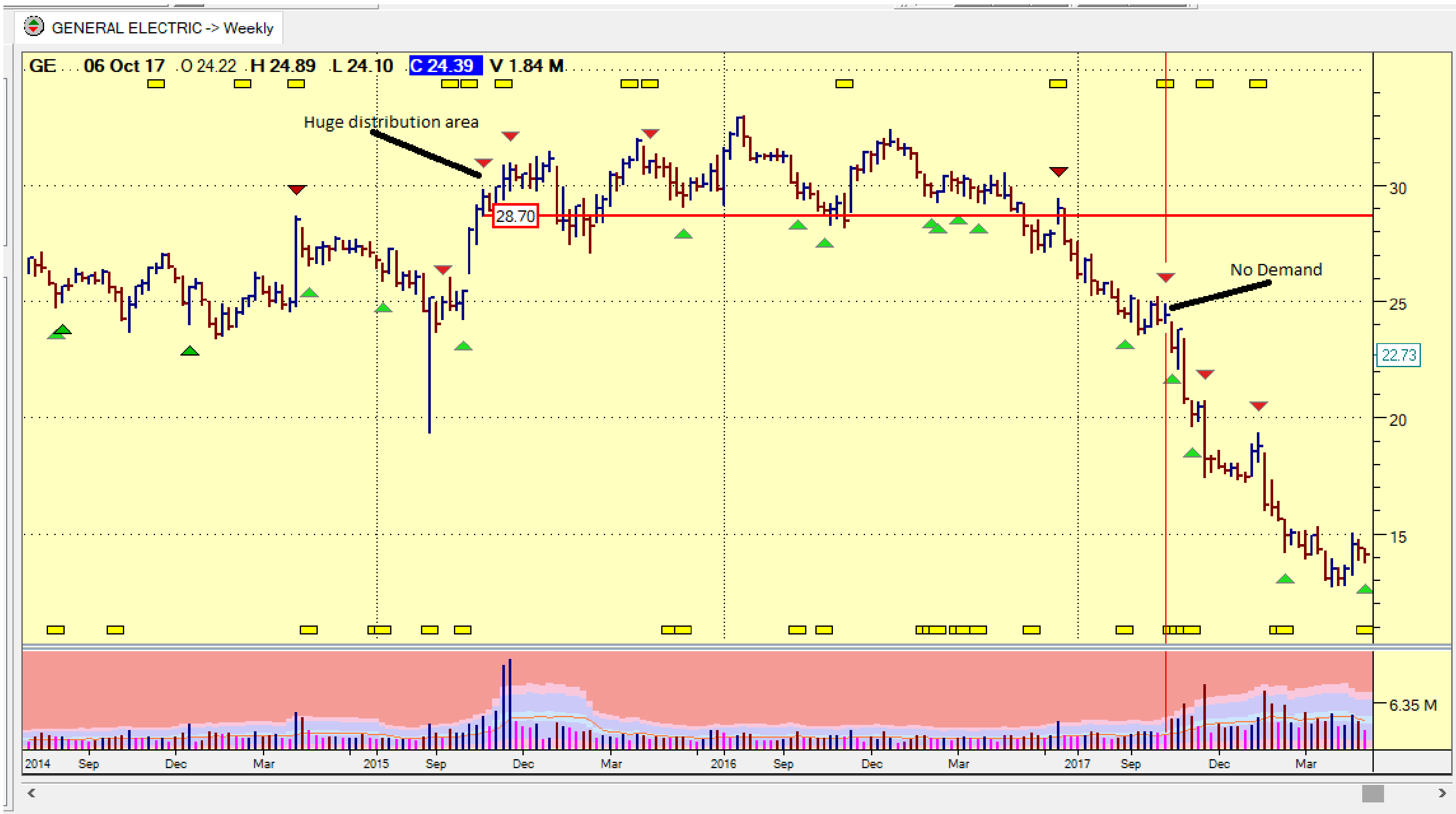
SELL SET UP 2

- This next set up is simpler to follow.
- Firstly look for a stock that is in a down trend with weakness in the background.
- Ensure that there are no huge volume bars in the background of the stock chart at lower prices as these will represent significant support.
- Make sure that the parent index is also in a downtrend.
- Look for no demand on the stock chart. This is a mark up in price on reduced volume (lower than the two previous bars and not high or greater volume). The bar should close off it’s high.
- Once price closes below the bottom of the no demand bar a short position can be considered. Make sure the subsequent bar is a weak bar (volume average to high but not huge, and closing near the low of the bar).
- A stop loss should be placed above the high of the last huge volume bar as it will take effort to push above it.
- Make sure that the ratio of risk/reward is at least 2:1 in your favour and aim to move the stop loss to break even as soon as possible.

SELL SET UP 2

- In the example on the next slide using General Electric price had already fallen below the distribution zone and the no demand highlighted on week ending 6th October 2017 gave a potential short entry. A note of caution here is that the parent index is still in an uptrend so this trade did not meet all the criteria.
- Once price moved down on the next bar and opened at 24.10 a short position could have been taken with a stop loss at just above 25.30 say 25.35.
- The risk would be 1.25 so a reward of 2.50 was needed to justify the trade. That meant price had to fall to a minimum of 21.60.
- As a new huge volume bar appeared the stop loss could have been quickly lowered to just above the high of that bar.
- Clearly this trade did not meet all of the criteria but a more advanced trader might have considered the risk was worthwhile. Newer traders are not advised to take such a position.

SELL SET UP 2



GENERAL ELECTRIC -> Weekly
GE 06 Oct 17 O 24.22 H 24.89 L 24.10 C 24.39 V 1.84 M
Huge distribution area
28.70
No Demand
30
25
22.73
20
15
6.35 M
2014
Sep
Dec
Mar
2015
Sep
Dec
Mar
2016
Sep
Dec
Mar
2017
Sep
Dec
Mar